

SECTION 65 IBC: BACKDOOR ENTRY FOR “EXTRANEOUS CONSIDERATIONS” WHILE DECIDING INSOLVENCY APPLICATIONS

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ABSTRACT

The Bankruptcy and Bankruptcy Code (IBC) has greatly improved procedural efficiency and ushered in a new era for corporate bankruptcy resolution in India. However, this complex legal system contains undetectable flaws that raise worries about possible abuse opportunities. These flaws have the potential to make it easier for bankruptcy applicants to use ad hoc channels, undermining the guiding objectives of the IBC, such as fair and open insolvency resolution. The focus is on the 65th section of the IBC, which governs the crucial choice of whether to accept or reject insolvency petitions when applications are made to commit fraud. Although this rule does not specifically mention "extraneous considerations," its inherent vagueness may unintentionally open the door for their adoption. To fortify the IBC's integrity, anticipatory measures need implementation. This requires putting in place strict controls during the application review process to make sure evaluations strictly adhere to the IBC's predetermined limits. Enhancing procedure transparency and heightening accountability can serve as deterrents against potential misuse. In conclusion, even while the IBC has a good effect on corporate insolvency in India, it is vulnerable, and thus careful evaluation is required. To foil attempts to take advantage of Section 65's provisions, a thorough analysis and proactive approach are essential. By using this strategy, the Indian corporate insolvency framework may maintain its effectiveness and integrity while preventing any covert manipulation of the procedure.

Keywords: Section 65, Extraneous Consideration, Fraudulent Intent.

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is the comprehensive law that governs the resolution of insolvency for all entities in India, including companies and individuals. The goal of codifying insolvency legislation is to provide legal consistency while making it less difficult for various stakeholders, who are impacted by business collapse or debt default to

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apply clear and consistent regulations. For India to advance towards becoming a fully developed market economy, the IBC was implemented. It responds to the growing demand for extensive legislation that would be efficient in addressing debtor insolvency, optimizing the worth of assets accessible to creditors, and facilitating the closure of unprofitable firms. Resolution is the Code's primary goal. The second goal is to increase the corporate debtor's asset worth, and the third one is to encourage entrepreneurship, credit availability, and a balance of interests. These goals must be completed in the exact sequence listed. The IBC's Section 65 is essential for ensuring that the correct cases join the insolvency resolution process while preventing system abuse. To assess the dangers of backdoor infiltration and make suggestions for methods to improve Section 65's efficacy, this paper looks deeply into its provisions¹.

UNDERSTANDING SECTION 65 OF THE CODE

Section 65² is covered in Part 2 Chapter 4 of the Insolvency and Bankruptcy Code, 2016. It deals with the fraudulent and malicious initiation of proceedings. Section 65 penalizes anyone who sets the machinery of the Code in action deliberately and with false purpose, with a minimum penalty of one lakh rupees and a maximum penalty of one crore rupees. It is worth noting that, while Section 65 imposes strict penalties for malicious and fraudulent initiation, the law itself fails to establish an avenue for uncovering malicious initiation of the corporate insolvency resolution process (CIRP), leaving the legal system in a state of mystery about who has the authority to bring a claim under the aforementioned section.

In reality, section 65 is only ever applied when someone takes legal action without any debt or default. The Adjudicating Authority will allow the application and begin the CIRP proceedings if the conditions of the relevant provisions (sections 7, 9, or 10) are met rather than investigating the reasons for starting the CIRP.

MISUSE OF SECTION 65

A corporate debtor (defaulting borrower) who may have conspired with the individual starting the fraudulent CIRP and ending such fraudulent CIRP is not subject to any penalties under

¹'Understanding the IBC - Insolvency and Bankruptcy Board of India' (ibbi.gov.in) <https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf>

² Editor, I.L. Read more: IBC laws - section 65 of IBC – Insolvency and bankruptcy code, 2016: Fraudulent or malicious initiation of proceedings, IBC Laws. Available at: <https://ibclaw.in/section-65-fraudulent-or-malicious-intiation-of-proceedings/>.

section 65³ of the Code. There have been multiple reports of applicants attempting to launch CIRP with malicious and fraudulent intent. Some of them are, for example, the initiation of proceedings by the same persons in different capacities for mischievous purposes⁴, the filing of unquantified petitions with false information⁵, and the filing of proceedings to divert the tribunal's attention from the main issue⁶.

There may be countless situations where procedures are initiated with fraudulent and malicious intent, which might contradict the objective of the IBC and lead to its provisions being exploited. When many actions are launched for the exact cause of action, the goal is also lost, and an outbreak of litigation is opened in appeals before the High Courts.

Under section 61⁷ of the IBC, any person dissatisfied with an order of the Adjudicating Authority or the National Company Law Appellate Tribunal may file an appeal with the National Company Law Appellate Tribunal. Since a subject relevant to the NCLT or NCLAT has been expressly eliminated by Sections 63 and 231 of the code, a final appeal regarding any order made by the NCLAT may be submitted before the Supreme Court under Section 62⁸ of the code, as well as the jurisdiction of any other civil court. However, the interference of various High Courts in IBC matters has grown in recent years, and it is important to understand how this ultimately bypasses the IBC hierarchy or appeals procedure and causes additional issues that undermine the IBC's goals.

UNDERSTANDING THROUGH JUDGMENTS

The basic ingredient to attract this provision is to have a proper basis that the proceeding has been initiated maliciously or fraudulently. Both things have to be proved before the court of law that is NCLT. Further, if anyone initiates the proceedings with fraudulent and malicious intent for a purpose other than the resolution of insolvency or liquidation then penalties have been provided for the same. If the intent is otherwise then provisions of the section will be attracted.

³ Section 65 of Insolvency and Bankruptcy Code, 2016

⁴ Embassy Property Developments (P) Ltd. v. State of Karnataka, 2019 SCC OnLine SC 1542

⁵ TATA Chemicals Limited v/s. Raj Process Equipments and Systems Private Limited, CP 21/I&BP/NCLT/MAH/2018

⁶ Shobhnath v. Prism Industrial Complex Ltd (2019)

⁷ Section 61 of Insolvency and Bankruptcy Code, 2016

⁸ Section 62 of Insolvency and Bankruptcy Code, 2016

Furthermore, The Hon'ble Madras High Court, in the case *S.T. Sahib vs. Hasan Ghani Sahib*,⁹ studied the word "malice" and noted that it would indicate "inappropriate" and erroneous intent to utilize the law for purposes other than those that are "legally appointed" and suitable purpose'. The prestigious Madras High Court has also noted that a bad purpose doesn't have to be malice aforethought; it could be an effort to get a competitive advantage.

The NCLAT further, in *Ashmeet Singh Bhatia v. Sundrm Consultants Pvt. Ltd. &Anr*,¹⁰ held that the application of Section 65 of the Insolvency and Bankruptcy Code, 2016 is maintainable following the filing of the application under any of Sections 7, 9, or 10 of the IBC. To confirm the applicant's ability to be maintained under Section 65, it is not essential for the application to be admitted and the Corporate Insolvency Resolution Process to start.

In the case of *SMBC Aviation Capital Limited v. Abhilash Lal, the Interim Resolution Professional of Go Airlines (India) Limited*¹¹, there was no application for insolvency made by a creditor; instead, the CIRP started as a result of a request made by the Corporate Applicant to the NCLT. The Corporate Applicant applied to prevent the lessors from seizing ownership of the aircraft and to safeguard itself from further financial difficulties that would have resulted in a breach of its obligations to the creditors. By going directly to NCLT and submitting an application for its insolvency to pay off its debts in the event of a downturn in business, the corporate applicant could follow a similar, quicker procedure to get a temporary financial reprieve that would go against the legislative intent.

In the case of *Amit Katyal vs. Meera Ahuja*¹² and Another, NCLAT held that initiation of proceedings under section 65 of the IBC is not a provision to negate the proceedings under section 7 and section 9. This is very important to note that penal actions under 65 can be taken only when the provisions of the code have been invoked fraudulently and with malicious intent.

Further, the Supreme Court in *Pioneer's case*¹³ held that home buyers who do not have an interest in taking possession and is only an investor has initiated the proceeding with malicious intent. The allottee does not want to go ahead with its obligation to take possession of the

⁹ *S.T. Sahib vs. Hasan Ghani Sahib 1956 SCC OnLine Mad 344*

¹⁰ *Ashmeet Singh Bhatia v. Sundrm Consultants Pvt. Ltd. &Anr, Company Appeal (AT) (Insolvency) No. 557 of 2021*

¹¹ *Abhilash Lal, the Interim Resolution Professional of Go Airlines (India) Limited Company Appeal (AT) (Insolvency) No. 593 of 2023*

¹² *Amit Katyal v. Meera Ahuja, 2022 SCC OnLine SC 257*

¹³ *Pioneer Urban Land and Infrastructure v Union of India 2019 SCC OnLine SC 1005*

apartment but wants to get back the monies already paid by way of coercive measures. It is important to note the word coercive action here and the court for the same held that the home buyer is misusing their position thus section 65 is justified. Court further held that it does not mean that any insolvency application satisfying the requirements of sections 7 and 9 of the Code could be dismissed arbitrarily under the guise of section 65 of the Code.

In other words, for anyone who is applying section 65, his intention, purpose, and sole object have to be very clear if he does not intend to resolve the matter or to ensure that the company goes into liquidation and the purpose is something else then section 65 cannot be used merely to ensure the dismissal of the section 7 petition. The Supreme Court in the same case of Amit Katyal, also upheld the finding by the NCLAT concerning sections 7 and 9.

The Adjudicating Authority ("AA") may refuse to admit an application that is otherwise complete in all respects under section 7 of the Insolvency and Bankruptcy Code, 2016 ("IBC") if there are obvious indications of fraud, collusion, or malicious intent under section 65 of the IBC, according to the National Company Law Tribunal ("NCLAT")'s ruling in *Hytone Merchants Pvt Ltd v. Satabadi Investments Consultants Pvt. Ltd*¹⁴. Unusually, the NCLAT opted to reject the application on its own under section 65, which means that the corporate debtor never averred that the application was false or maliciously motivated.

The law about section 7(5) of the IBC has been laid out in the authoritative ruling of *Innoventive Industries Ltd. v. ICICI Bank*¹⁵, where the Apex court held that "the moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete, in which case it may give notice to the applicant to rectify the defect within 7 days of receipt of a notice from the adjudicating authority."

Furthermore, the NCLAT ruled in *Shobhanath v. Prism Industries*¹⁶ that the AA is only obligated to determine if there is a debt and a default and cannot take into account any other irrelevant or unnecessary factors. Since the application met the criteria outlined in section 7 in *Hytone merchant's case*¹⁷, it can be confidently argued that the Adjudicating Authority's

¹⁴ *Hytone Merchants Private Limited vs Satabadi Investment Consultants COMPANY APPEAL (AT) (INSOLVENCY) NO. 258 OF 2021*

¹⁵ *M/S. Innoventive Industries Ltd vs Icici Bank &Anr,2017 SCC OnLine SC 1025*

¹⁶ *Shobhnath & Ors vs Prism Industrial Complex Ltd (2019)*

¹⁷ *Hytone Merchants Private Limited vs Satabadi Investment Consultants COMPANY APPEAL (AT) (INSOLVENCY) NO. 258 OF 2021*

decision to deny the application was improperly influenced by factors not covered by section 7.

CONCLUSION

It can be said that decisions given by the Adjudicating Authority broaden the purview beyond the limitations of Section 7. Section 65 gives a chance to the applicants to file an application if they find any fraudulent and malicious intention. In some cases even if there is a default and the creditor applies to sections 7, 9 or 10 then in a case Adjudicating Authority can deny applications notwithstanding a genuine default.

Further, an applicant can file the simultaneous application when the application under sections 7,9 or 10 has been filed it is not necessary that it has to be filed only after admission, which thus gives a chance to the person filing under section 65 to delay the proceedings or to create hindrance in the section 7,9 or 10 proceedings. There can be instances where the application is filed by the corporate debtor itself or an applicant is just a tool in the hands of the corporate debtor.

Accordingly, the adjudicating authority must take particular account of the issue before it and should closely examine these requests to decide whether or not there is an association between parties. There might be cases where the corporate debtor does not want to pay back the creditors and might do some settlement with the secured or priority creditors and at the time of liquidation end up avoiding payment to the creditors who are not the priority or stand last in the list of priority creditors.

The Adjudicating Body should examine the prima facie facts and information available on record before accepting an application in so far as the applicant can demonstrate that any requirements of the law must be met, whether or not the corporate debtor acknowledges a debt and does not oppose insolvency proceedings.